

**THIS DRAFT IS NOT TO BE CONSIDERED A PROPOSED RULE AND IS ONLY PROVIDED FOR DISCUSSION PURPOSES TO DETERMINE WHAT TOPICS A LATER PROPOSED RULE MIGHT ADDRESS. UNDER NO CIRCUMSTANCES IS THIS DISCUSSION DRAFT TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.**

Amendatory Section: (Amending WSR 96-03-139, filed 1/24/96, effective 2/24/96)

**WAC 458-20-211 Leases or rentals of tangible personal property, bailments and demurrage charges.** (1) **Introduction.** ~~This section explains how persons are taxable who rent or lease tangible personal property or rent equipment with an operator. RCW 82.04.050 (4) was amended by chapter 25, Laws of 1993 sp. sess. to specifically include the rental of equipment with an operator as a retail sale. However, as will be explained in more detail below, some activities performed by operated equipment may be taxable under classifications other than retail sales if the operator and equipment perform activities as a prime contractor or subcontractor and these activities are specifically classified under other tax classifications by the revenue act.~~

(2) **Definitions.** (a) ~~The terms "leasing" and "renting" are used interchangeably and refer generally to the act of granting to another the right of possession to and use of tangible personal property for a consideration. When "lease," "leasing," "lessee," or "lessor" are used in this section, these terms are intended to include rentals as well, even if not specifically stated.~~

~~Persons may not claim to be leasing or renting equipment to themselves since they are not granting to another the right of possession.~~

(b) ~~The term "bailment" refers to the act of granting to another the temporary right of possession to and use of tangible personal property for a stated purpose without consideration to the grantor.~~

(c) ~~The term "subcontractor" refers to a person who has entered into a contract for the performance of an act with the person who has already contracted for its performance. A subcontractor is generally responsible for performing the work to contract specification and determines how the work will be performed. In purchasing subcontract services, the customer is primarily purchasing the knowledge, skills, and expertise of the contractor to perform the task, as distinguished from the operation of the equipment.~~

(d) ~~The term "rental of equipment with operator" means the provision of equipment with an operator to a lessee to perform work under the specific direction of the lessee. In such cases the lessor is generally not responsible for performing work to contract specification and does not determine how the work will be performed. Though not controlling, persons who rent equipment with an operator typically bill on the basis of the amount of time the equipment was used.~~

(e) ~~The term "true object test" as it relates to this section means the analysis of a transaction involving equipment and an operator to determine if the lessee is simply purchasing the use of the equipment or purchasing the knowledge, skills, and expertise of the operator beyond those needed to operate the equipment. Even if it is determined that the customer is purchasing the knowledge, skills, and expertise of the operator, the transaction may still be a retail sale if the activity is specifically included by statute within the definition of a retail sale. This test can also be applied to rentals of tangible personal property when the seller performs some service in connection with the rental.~~

(f) ~~The term "true lease" (often referred to as an "operating lease") refers to the act of leasing property to another for consideration with the property under the dominion and control of the lessee for the term of the lease with the intent that the property will revert back to the lessor at the conclusion of the lease.~~

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~~(g) The term "financing lease" (often referred to as a "capital lease") typically involves the lease of property for a stated period of time with ownership transferring to the "lessee" at the conclusion of the lease for a nominal or minimal payment. The transaction is structured as a lease, but retains some elements of an installment sale. Financing leases will generally be taxed as if they are installment sales. The presence of some or all of the following factors indicates a financing lease with the transaction treated as an installment sale:~~

~~(i) The lessee is given an option to purchase the equipment, and, if so, the option price is nominal (sometimes referred to as a "bargain purchase option");~~

~~(ii) The lessee acquires equity in the equipment;~~

~~(iii) The lessee is required to bear the entire risk of loss;~~

~~(iv) The lessee pays all the charges and taxes imposed on ownership;~~

~~(v) There is a provision for acceleration of rent payments; and~~

~~(vi) The property was purchased specifically for lease to this lessee.~~

~~(3) A true lease, rental, or bailment of personal property does not arise unless the lessee or bailee, or employees or independent operators hired by the lessee or bailee actually takes possession of the property and exercises dominion and control over it. Where the owner/lessor of the equipment or the owner's/lessor's employees or agents maintain dominion and control over the personal property and actually operate it, the owner/lessor has not generally relinquished sufficient control over the property to give rise to a true lease, rental, or bailment of the property.~~

~~(4) RCW 82.04.050 excludes from the definition "retail sale" any purchases for the purpose of resale, "as tangible personal property." Persons who use equipment in performing services either as prime contractors or as subcontractors are not purchasing the equipment for purposes of reselling the equipment as tangible personal property. These contractors must pay retail sales tax or use tax at the time the equipment is acquired. Generally persons who rent equipment with an operator are not purchasing the equipment for resale as tangible personal property and must pay retail sales or use tax at the time the equipment is acquired. Persons renting operated equipment to others may purchase the equipment without payment of retail sales tax only when the equipment is rented as tangible personal property. This can be demonstrated only when:~~

~~(a) The agreement between the parties is designated as an outright lease or rental, without reservations; and~~

~~(b) The lessee acquires the right of possession, dominion, and control of the equipment, even to the exclusion of the lessor.~~

~~This last requirement is a factual question and the burden of proof is upon the owner/operator of the equipment to establish that the degree of control has been relinquished necessary to constitute a lessor-lessee relationship. Weight will be given to such factors as who has physical, operating control of the equipment; who is responsible for its maintenance, fueling, repair, storage, insurance (risk of loss or damage), safety and security of operation, and whether the operator is a loaned employee. If control of these factors is left with the owner/operator, then as a matter of fact, there has not been a relinquishing of control of the equipment to the degree necessary to create a lessor-lessee relationship for the rental of tangible personal property. This is true, even though the customer exercises some constructive control over such matters as when~~

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and where the equipment is used in connection with the construction work being performed, i.e., the contractor controls the job site.

**5) ~~Business and occupation (B&O) tax.~~**

~~(a) Outright rentals of bare (unoperated) equipment or other tangible personal property as well as leases of operated equipment are generally subject to the retailing classification of the business and occupation tax.~~

~~(i) When a lessor purchases equipment for bare rental or lease, the seller of the equipment is making a wholesale sale to the lessor and is required to obtain a resale certificate from the lessor as provided in WAC 458-20-102.~~

~~(ii) Under unique circumstances when equipment is rented for re-rent by the lessee, without intervening use, then the original rental is subject to the wholesaling classification of tax and the subsequent rental is subject to the retailing classification. The original seller is required to obtain a resale certificate for these wholesale sales.~~

~~(iii) Persons who purchase equipment for use as prime contractors or subcontractors are considered to be the consumers of these purchases. They are the consumers because they are not specifically reselling the tangible personal property. Persons selling equipment to these persons are retailers and subject to the retailing B&O tax.~~

~~(b) Persons who provide equipment or other tangible personal property and, in addition, operate the equipment or supply an employee to operate the same for a charge, without relinquishing substantial dominion and control to the customer, are providing a service that is classified as a retail sale unless the nature of the activity is specifically classified under another tax classification. Where a specific tax classification applies to the activity, the income is subject to the business and occupation tax (or public utility tax) according to the classification of the activities performed by the equipment and operator. In the case of building construction, it will be presumed that the rental of equipment with operator to a contractor is a retail sale unless the operator has responsibility for performing construction to contract specifications and assumes control over how the work will be performed.~~

~~(c) Under some circumstances, the leasing or renting of tangible personal property can be subject to the special "retailing of interstate transportation equipment" B&O tax classification. This classification applies if the sale is exempt from retail sales tax because of the specific tax exemptions of RCW 82.08.0261, 82.08.0262, or 82.08.0263. These exemptions apply primarily to sales to private or common carriers who are engaged in interstate or foreign commerce.~~

~~(d) The following examples show how the tax would be applied to certain situations.~~

~~(i) The charge made by a subcontractor to a prime construction contractor for use of equipment with an operator used in the paving of a parking lot as part of the construction of a building would be taxable under wholesaling — other when the subcontractor has the responsibility to perform the work to contract specification and determines how the work will be performed.~~

~~(ii) A contractor performing work to contract specification making a charge to a city for use of equipment and operator in the construction of a publicly owned road would be taxable under public road construction.~~

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(iii) Income for loading of a vessel using equipment with an operator is taxable under the stevedoring classification.

(iv) Income from transporting persons or property for hire by motor vehicle, including leasing or renting motor carrier equipment with driver, is generally taxable under either motor transportation or urban transportation.

(v) A customer rents scaffolding and the seller is responsible for a technician to setup, move, and dismantle it. This is the rental of tangible personal property since the true object of the transaction is having the scaffolding available for use by the customer. The customer also assumes dominion or control over the scaffolding by determining who will use the scaffolding and by controlling the use of the scaffolding.

(vi) Income from transporting persons or property for hire by vessel is not a retail equipment rental with operator.

(6) **Retail sales tax.** Persons who rent or lease tangible personal property to users or consumers are required to collect from their lessees the retail sales tax measured by gross income from rentals as of the time the rental payments fall due.

(a) RCW 82.04.050 excludes from the definition of the term "retail sale," purchases for resale "as tangible personal property." Thus the retail sales tax does not apply upon sales of tangible personal property to persons who purchase the same solely for the purpose of renting or leasing such property without operators. However, the retail sales tax applies upon sales to persons who provide such property with operators for a charge, without relinquishing substantial dominion and control, or who intend to make some use of the property other than or in addition to renting or leasing.

(b) Financing leases are treated for state tax purposes as installment sales. The retail sales tax applies to the full selling price. Refer to WAC 458-20-198.

(c) The retail sales tax does not apply to lease payments made by a seller/lessee under a sale/leaseback agreement in respect to property, equipment, and components used by the seller/lessee primarily in the business of canning, preserving, freezing, or dehydrating fresh fruits, vegetables, and fish. Nor does the sales tax apply to the purchase amount paid by the lessee pursuant to an option to purchase this specific kind of processing equipment at the end of the lease term. (See RCW 82.08.0295.) In both situations the availability of this special sales tax exemption is contingent upon the seller/lessee having paid retail sales tax or use tax at the time of acquisition of such special processing property, equipment, and components. The use tax will also not apply if the sales tax does not apply.

(7) **Use tax and/or deferred retail sales tax.** Consumers who rent or lease tangible personal property from others and who have not paid the retail sales tax to their lessors are liable for the retail sales tax or use tax on the amount of the rental payments as of the time the payments fall due unless an exemption from the tax applies. However, if the rental payments do not represent a reasonable rental value for the article, the taxable value shall be determined according to the rental charges made by other sellers of similar articles of like quality and character. This can include using the rate of return as a percentage of the capitalized value that lessors of the particular type of property are generally using in rate setting.



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~~In some cases lessors may lease articles wherein the lease payments do not include property taxes or insurance. These leases are often referred to as "net leases" with the insurance and taxes paid directly by the lessee. If the lessor is the party insured and the party legally liable for payment of the taxes, the payments made directly by the lessee must be treated as additional consideration to the lessor and subject to the retailing and retail sales tax.~~

~~(a) Bailment. The value of tangible personal property held or used under bailment is subject to use tax if the property was purchased or acquired under conditions whereby the retail sales tax was not paid by the bailor. Tax liability is that of the bailor, or of the bailee if the bailor has not paid the tax. The measure of the tax to the bailor is the fair market value of the article at the time the article was first put to use in Washington. The measure of the use tax to the bailee for articles acquired by bailment is the reasonable rental with the value to be determined as nearly as possible according to the rental price at the place of use of similar products of like quality and character. In the absence of rental prices for similar products, the reasonable rental may be computed by prorating the retail selling price over the period of possession had by a bailee and payable in monthly installments. No further use tax is due upon property acquired by bailment after tax has been paid by the bailee or any previous bailee upon the full original value of the article.~~

~~(b) Use tax does not apply to use by a bailee of any article of tangible personal property which is entirely consumed in the course of research, development, experimental, and testing activities conducted by the user, providing the acquisition or use of such articles by the bailor are exempt from sales or use tax. (RCW 82.12.0265.)~~

~~(8) **Examples.** The following examples identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax results of other situations must be determined after a review of all of the facts and circumstances. In some situations it may be difficult to determine if the transaction is a retail equipment rental with operator. If in doubt as to whether a particular rental with an operator is a retail sale, taxpayers should contact the department for a specific ruling.~~

~~(a) ABC Crane is hired to supply a crane and operator to lift air conditioning equipment from the ground and hold it in place on the roof of a six story building while the prime construction contractor bolts the unit down. ABC Crane's operator will retain control over the crane. ABC Crane has no responsibility to attach wiring, plumbing, or otherwise make the unit operational. ABC Crane is renting equipment with an operator since it has no responsibility to perform actual construction to contract specification. The activity of renting a crane with an operator is a service included within the definition of a retail sale and is not otherwise tax classified elsewhere within the revenue act. The purchase of the crane by ABC is also a retail transaction because ABC retained control over the crane and is not renting the crane as tangible personal property.~~

~~(b) ABC Crane is hired by a prime contractor to install a neon sign on the side of a new six story building which is being constructed. ABC is responsible for making certain that the sign is correctly fastened to the side of the building and for installation of the electrical connections and meets the proper building codes. ABC is directly involved in construction and performs work to contract specification. Since the work is being done for the prime contractor~~

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~~for further resale, this is a wholesale sale, provided a resale certificate is obtained. Had ABC only been hired to hold the sign in place while the prime contractor fastened it, this would have been a retail rental of equipment with operator.~~

~~(c) XYZ Concrete Pumping is hired by a prime contractor to supply a concrete pump and operator to pump concrete from a premix concrete delivery truck to the location of the forms. XYZ has no responsibility to build forms, do the concrete finishing, or otherwise see that the concrete meets or is placed according to contract specifications. In short, the pump functions similarly to a wheelbarrow, but in a more efficient manner. XYZ is not a subcontractor and is making a retail rental of equipment with an operator.~~

~~(d) ABC Company purchases a crane which it rents to others as a bare rental. It periodically rents the crane to lessees on this basis for two years. Beginning in the third year of ownership of this crane, ABC decides to start providing these customers with an employee to operate the crane. The employee will operate under the direction of ABC with ABC retaining dominion and control over the crane. Does ABC owe use tax on the crane, and if so, what is the measure of the use tax?~~

~~ABC owes use tax upon the first use of the crane as a consumer. This occurred in the third year of ownership when ABC began supplying an operator. The measure of the tax is the retail market value of the crane at the time it is put to use by ABC.~~

~~(e) Farm Services, Inc. specializes in the cutting and baling of hay for farmers. The hay, after being cut and baled, is sold by the farmer. Farm Services is not making a retail rental of equipment with operator, but is engaged in a farming for hire activity which is taxable under the service and other business activities B&O tax classification. See WAC 458-20-209.~~

~~(f) Helicopter, Inc. contracts with Logs, Inc. to move logs from where they have been cut in the woods to a landing approximately one mile away where the logs will be sorted, loaded on trucks, and transported to a mill. Total control over the helicopter operation rests with Helicopter, Inc. This is not a rental of equipment with an operator, nor is it considered as an air transportation service. This activity is directly part of the timber extracting and harvesting activity and is taxable as extracting for hire.~~

~~(g) ABC Sound Productions provides lighting, amplifying equipment, and speakers as part of the services it sells to entertainment promoters. ABC also provides several operators of the equipment. This is a rental of equipment with operator. In applying the true object test, the promoter is primarily purchasing the use of the lighting and sound equipment. The performer or promoter could be expected to specify the color, location, and degree of lighting and may also request changes and modifications to the level of sound amplification during the performance.~~

~~(h) John Doe purchased a vessel which will be rented to others as a bare boat rental. The rentals will be arranged through an agent at a marina. The marina receives a commission based on any usage of the vessel, including usage by the owner. The rental of the boat is a retail sale when the boat is rented to others. The usage of the boat by John Doe is not a rental. Since John Doe will be using the boat at times for his own use, he may not purchase the boat for resale. This rule explains the business and occupation (B&O), retail sales, and use tax reporting responsibilities of persons renting or leasing tangible personal property. It also explains how tax applies to bailment situations and demurrage charges. RCW 82.04.050 includes within the~~

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definition of a retail sale the renting or leasing of tangible personal property to consumers. In 2003, the Legislature adopted the definition of "lease or rental" as set forth in the national Streamlined Sales and Use Tax Agreement. This definition, effective July 1, 2004, identifies the circumstances under which a transaction is a lease or rental of tangible personal property or the providing of tangible personal property along with an operator. To determine the application of tax for periods before July 1, 2004, the reader should refer to the previous version of this rule.

For the purposes of this rule, the terms "lease" or "rental" are used interchangeably. The terms "lease," "leasing," "lessor," and "lessee" include rentals even if not specifically indicated.

Additional taxes apply to retail rental cars and leased motor vehicles. Persons who provide retail car rentals should also refer to RCW 82.08.011, 82.08.020, and 82.14.049. Persons who lease motor vehicles should also refer to RCW 82.08.020, chapter 361, Laws of 2003.

(2) **What is a lease or rental?** A lease, often referred to as a true lease, an operating lease, a bare rental, or an unoperated rental, is any transfer of possession or control of tangible personal property to another person for a fixed or indeterminate term for consideration. This is so notwithstanding that a lessor may transfer possession and control while maintaining a responsibility to maintain, inspect, or set up the tangible personal property.

(a) **Transactions that are leases.** A transaction meeting the definition of a lease or rental as provided in this subsection will be considered a lease for tax purposes regardless of whether the transaction is characterized as a lease or rental under generally accepted accounting principles, the United States Internal Revenue Code, Washington state's commercial code or other provisions of federal, state, or local law. RCW 82.04.040 and chapter 168, Laws of 2003. A transaction may be characterized as a lease even though one of the following may exist:

(i) The lease contains future options to extend the lease period or purchase the property.

(ii) The transaction is under an agreement covering motor vehicles and trailers where the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property as defined in 26 United States Code Sec. 7701(h) (1), as amended or renumbered as of January 1, 2003.

(b) **Transactions that are not leases.** A transaction that includes one of the following will not be considered a lease for tax purposes:

(i) A transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments. Such transfers are taxable as conditional or installment sales. For discussion about the taxability of income from such sales, refer to WAC 458-20-198 (Conditional and installment sales, method of reporting) and WAC 458-20-109 (Finance charges, carrying charges, interest, penalties).

(ii) A transfer of possession or control of property under an agreement that requires the transfer of title upon completion of required payments, and payment of an option price does not exceed the greater of one hundred dollars or one percent of the total required payment. Such transfers are taxable as conditional or installment sales.

(iii) Providing tangible personal property along with an operator for a fixed or indeterminate period of time. For discussion about the taxability of income from providing

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tangible personal property along with an operator, refer to WAC 458-20-266 (Providing tangible personal property along with an operator).

(3) **Tax-reporting responsibilities associated with income from a lease.** The gross proceeds of sales from the lease of tangible personal property to a consumer are generally subject to the retailing B&O tax. Lessors are also responsible for collecting and remitting retail sales tax on the selling price when leasing property to consumers, unless a specific exemption applies. The B&O and retail sales taxes apply as the rental payments fall due.

When a lease of tangible personal property is for the purpose of subleasing or subrenting the property as tangible personal property, the gross proceeds of sales are subject to the wholesaling B&O tax. The lessor must obtain a resale certificate from the lessee to document the wholesale nature of the sale as provided by WAC 458-20-102 (Resale certificates).

(a) **What is included in “gross proceeds of sales” and/or “selling price?”** The terms “gross proceeds of sales” and “selling price” include all consideration paid, however identified, without any deductions for costs of doing business. RCW 82.04.070 and 82.08.010.

(i) In the case of a lease, consideration includes, but is not limited to the following:

(A) The lease payment.

(B) Amounts itemized and collected by the lessor for insurance or property taxes.

(C) Payments for insurance and taxes that the lessee pays directly but for which the lessor is the insured party or is legally liable (sometimes referred to as a net lease).

(D) Charges for repair or maintenance for which the lessor is responsible when paid directly by the lessee and deducted from the lease payment.

(E) Additional consideration received by the lessor from an early payoff of a lease, a negotiated lease settlement, or an early lease termination. Conversely, amounts refunded by the lessor to the lessee because of a negotiated lease settlement or early lease termination are a reduction of the consideration paid by the lessee to the lessor.

(ii) For retail sales tax purposes only, consideration does not include trade-in property of like kind. For further discussion about the retail sales tax exclusion for trade-in property of like kind, refer to WAC 458-20-247 (Trade-ins, selling price, seller's tax measures).

(b) **When the lease payment does not represent a reasonable rental value.** When the consideration paid does not represent a reasonable rental for the use of the property, the “selling price” for purposes of retail sales tax must be determined as nearly as possible according to the value of such use at the places of use of similar articles of like quality and character. RCW 82.08.010. When determining if the consideration paid is reasonable, a lessor must consider an allowance for the recovery of investment (depreciation), maintenance costs, overhead, and a reasonable profit margin.

A reasonable rental is based on the total time the property is available for use by the lessee, not just the time of actual physical use. For example, Lessee enters into a six-month agreement with Lessor to lease a yacht. The yacht is at all times available to Lessee, however, Lessee takes the yacht cruising seven days a month. When determining whether the consideration Lessee pays to Lessor represents a reasonable rental, the reasonable rental must be attributable to the full period the yacht is available for use by Lessee, not just the seven days a month Lessee actually takes the yacht cruising



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(c) **Purchases of and repairs to property to be leased.** The purchase of tangible personal property and component parts thereof for lease without intervening use to other persons as tangible personal property is a wholesale purchase. Likewise, the purchase of services rendered in respect to installing, repairing, cleaning, altering, imprinting, or otherwise improving such property is a wholesale purchase. Such purchases are not subject to retail sales tax when the buyer provides a resale certificate to the seller as discussed by WAC 458-20-102 (Resale certificates).

(d) **Determining the appropriate local sales tax rate.** For purposes of determining the appropriate state and local sales tax rate, the periodic or non-periodic nature of the lease determines the place of sale. For assistance with determining jurisdictional boundaries, local tax rates, and location codes, the department's geographic information system (GIS) provides a mapping and address lookup system. The system is available on the department's Internet site at: <http://dor.wa.gov>.

(i) **Non-periodic lease.** A non-periodic lease is a short term, ordinary lease. For a short-term lease, the place sale occurs at the place of first use by the lessee or renter. For practical purposes, the lessor's place of business is considered the place of first use.

(A) **Example 1.** A Redmond business rents tents and generators to the promoter of a weekend event occurring in Issaquah. Payment is due upon return of the property. The lessor's Redmond location is the place of sale for local sales tax purposes.

(B) **Example 2.** A Bellingham equipment rental business delivers a backhoe to a Ferndale location for two days use by the lessee. A deposit is due upon delivery and full payment for the rental is due when the lessor retrieves the backhoe. The lessor's Bellingham location is the place of sale for local sales tax purposes.

(ii) **Periodic lease.** A periodic lease is one in which the lessee agrees to make regular rental payments at specified intervals. These are normally longer-term rentals requiring a monthly rental payment on or before a certain date. The place of sale for a periodic or long-term lease is the primary place of use during each period covered by each periodic payment. If the lessee is a business, the lessee's place of business will be considered the place of primary use. When the lessee has several business locations, the place where the property is assigned or regularly returned will be considered the place of primary use. If the lessee is a private individual, the place of primary use will be considered the lessee's residence.

(A) **Example 1.** A Kennewick construction company leases fencing from a Pasco firm to surround two construction projects, both with Richland addresses. Expecting each project to last for three to four months, the company enters into a lease agreement requiring monthly lease payments. Using GIS, the lessor determines that one project is within Richland and the other is located in Benton County. For local sales tax purposes, the Richland location is the place of sale for fencing located at the Richland site and the Benton County location is the place of sale for fencing located at the Benton County site.

(B) **Example 2.** A Seattle leasing company leases an automobile to a Puyallup resident who works in Renton. The lease agreement requires a monthly lease payment for 36 months. The place of sale for local sales tax purposes is the lessee's Puyallup residence.

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**(e) The effect of out-of-state use of leased property on the measure of B&O and retail sales tax.** Neither the B&O tax nor the retail sales tax applies to that portion of a lease payment representing the lessee's use of the property outside this state. A lessor who prorates the taxable amount of lease income based on the degree of use occurring in Washington must maintain adequate records substantiating any claim that a portion of lease income is exempt from tax because of a lessee's use of property outside Washington.

When apportioning the use of leased property inside and outside the state, the in state use must be based on the total time the property is available for use within Washington, not just the time of actual physical use. For example, Lessee enters into a one-year agreement with Lessor for the lease of an aircraft. On average, Lessee flies the aircraft 20 days a month, 6 of which the aircraft is used outside the state. The aircraft is hangared or undergoing maintenance in this state during the remaining 10 days of the month. Thus, the taxable portion of the lease payment representing the Lessee's in-state use of the aircraft is determined by the 24 days the aircraft is available for Lessee's use in Washington, not just the time the aircraft is in actual flight.

**(f) Lessee liable for sales tax when lessor fails to collect retail sales tax.** If a lessor fails to collect the retail sales tax, the lessee is responsible for remitting retail sales tax (commonly referred to as "deferred sales tax") directly to the Department, unless the lease transaction is exempt by law. The tax is due as each rental payment falls due. Refer to subsection (3)(a) of this rule for discussion about the measure of tax.

In those unique circumstances where the lessor is not required to remit collected retail sales tax from the lessee (see subsection (3)(j)), the lessee is liable for use tax.

**(g) Sale of rental inventory.** The sale of inventory held for lease is subject to the B&O tax and retail sales tax, unless a specific exemption applies. This is true even though the seller's primary business activity is renting the inventory. The sale is not a casual or isolated sale because a person renting property to another is in the business of selling that property. RCW 82.04.040 and WAC 458-20-106 (Casual or isolated sales – Business reorganizations).

**(h) Converting rental inventory to personal use.** The use of rental inventory as a consumer is subject to use tax. For example, Marina purchases a motorboat to rent to others without a crew (a bare rental basis). Marina purchases the motorboat at wholesale and provides the seller with a resale certificate. Marina exclusively rents the motorboat to others for two years, and then charts the motorboat with a crew for a week. Marina is not transferring possession and control because Marina provides a crew and/or captain. Consequently, the transaction is not a lease or rental. Marina has used the motorboat as a consumer and incurs a use tax liability. The measure of use tax is the value of the motorboat at the time of Marina's first use as a consumer. RCW 82.12.010. See also WAC 458-20-178 (Use tax) for a discussion about determining the "value of article used."

**(i) Special B&O tax classification—Leases to persons engaging in certain interstate or foreign commerce transportation activities.** The retailing of interstate transportation equipment B&O tax applies to the gross proceeds of sales when the sale or lease of certain tangible personal property used to conduct interstate or foreign air, rail, water, or land transportation activities is exempt from sales tax under RCW 82.08.0261, RCW 82.08.0262, and RCW 82.08.0263. RCW 82.04.250(2). For further information about sales to persons engaged

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in interstate or foreign transportation activities, refer to WAC 458-20-174 (Sales of motor vehicles, trailers, and parts to motor carriers operating in interstate or foreign commerce) and WAC 458-20-175 (Persons engaged in the business of operating as a private or common carrier by air, rail, or water in interstate or foreign commerce).

If certain conditions are met, income derived from the lease (or sale) of commercial aircraft may be subject to a special B&O tax classification. For further information, refer to chapter 1, Laws of 2003, 2nd sp.sess.

**(j) Tax-reporting responsibilities of out-of-state lessors leasing tangible personal property used in this state.** Except as noted below, a lessor located outside this state who leases tangible personal property is subject to the B&O tax if the property is being used in Washington. If the lessee is a consumer, the lessor is responsible for collecting the retail sales tax, unless a specific exemption applies. It is immaterial that first possession of the leased property occurs outside the state or that the lease agreement is consummated outside the state.

An out-of-state lessor is not subject to the B&O tax or the requirement to collect retail sales tax if all of the following conditions exist:

(i) The equipment is not located in Washington when the lessee first takes possession of the leased property;

(ii) The lessor has no reason to know that the lessee will use or is using the property in Washington; and

(iii) The lease agreement does not require the lessee to notify the lessor when moving the property and the lessor has no reason to know that the property has been moved to Washington.

**(k) Sale and leaseback transactions.** A sale and leaseback arrangement occurs when a buyer purchases tangible personal property, sells the property to another buyer and then leases the property back from that buyer.

**(i) Buyer's purchase of leaseback property.** The buyer's initial purchase of tangible personal property from the seller is a wholesale purchase if:

(A) Before the purchase, the buyer documents intent to sell and leaseback the property by executing or committing to execute an agreement to sell and leaseback the property;

(B) No intervening use occurs between the time of purchase and the subsequent sale and leaseback; and

(C) The buyer provides a resale certificate to the seller as discussed by WAC 458-20-102 (Resale certificates).

**(ii) Buyer's sale to lessor.** The buyer's subsequent sale to the lessor is subject to the wholesaling B&O tax if the lessor provides a resale certificate to the buyer as discussed by WAC 458-20-102.

**(iii) Lessor's lease to buyer.** The lessor's lease to the buyer is subject to B&O tax and retail sales tax as provided elsewhere in this rule, unless a specific exemption applies.

**(iv) Effect of intervening use by buyer before sale to lessor.** Sales tax applies to both the initial purchase of property and subsequent leaseback transaction if a person purchases property, and puts it to an intervening use before entering into a sale/leaseback arrangement.

For example, Retailer purchases and installs the cash registers at its business location. Retailer subsequently determines leasing the cash registers provides more advantages than

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outright ownership. Retailer sells the cash registers to a leasing company and leases them back. The initial purchase of the cash registers is subject to retail sales tax because Retailer's use of the cash registers between the period of purchase and resale constitutes intervening use. The lease payments under the lease back agreement are also subject to retail sales tax.

**(v) Exemption—Sale/leaseback of property used in the business of processing fresh fruits, vegetables, and fish.** RCW 82.08.0295 provides a retail sales tax exemption for amounts paid by a seller/lessee to a lessor under a sale/leaseback agreement in respect to property, including equipment and components used by the seller/lessee primarily in the business of canning, preserving, freezing, or dehydrating fresh fruits, vegetables, and fish. This exemption also applies to the purchase amount paid by the lessee pursuant to an option to purchase this specific kind of processing equipment at the end of the lease term. In both situations, the availability of this special sales tax exemption is contingent upon the seller/lessee having paid retail sales tax at the time of acquisition of such special processing property, equipment, and components. RCW 82.12.0295 provides a comparable use tax exemption. There is no comparable B&O tax exemption. For the purposes of this exemption, “primarily” means more than fifty percent.

**(l) Leases between related entities.** Each separately organized entity (for example, corporation, partnership, joint venture) is a person under RCW 82.04.030, regardless of its affiliation with another entity. The law makes no provision for consolidating or eliminating transactions between such entities. Thus, B&O and retail sales taxes apply to leases or rentals between related entities, unless a specific exemption applies. For example, a parent corporation forms a wholly owned subsidiary to acquire and lease property to the parent. The subsidiary is subject to the retailing B&O tax upon the gross proceeds of sales and is responsible for collecting and remitting retail sales tax on the selling price to the parent corporation. RCW 82.04.030.

**(m) Lease of property manufactured by the lessor.** The value of tangible personal property manufactured in this state and leased by the manufacturer within or without this state is subject to the manufacturing B&O tax. In addition, gross proceeds of sales from the lease are subject to tax as described elsewhere in this rule. Persons manufacturing property and leasing the same in this state may claim a multiple activities tax credit. Refer to WAC 458-20-136 (Manufacturing, processing for hire, fabricating) and WAC 458-20-19301 (Multiple activities tax credits) for information about manufacturing activities.

**(i) Value of the article manufactured.** Generally, the value of the article manufactured is the same as the gross proceeds of sales. With respect to the lease of such property, the gross proceeds from the rental payments may not reflect the value of the article manufactured. For purposes of computing the manufacturing B&O tax in such instances, the value of the article manufactured must correspond as nearly as possible to the gross proceeds from sales in this state of similar products of like quality and character, and in similar quantities by other taxpayers, plus the amount of subsidies or bonuses ordinarily payable by the purchaser or by any third person with respect to the extraction, manufacture, or sale of such products. RCW 82.04.450. For further discussion, refer to WAC 458-20-112 (Value of products).

**(ii) Reporting the manufacturing B&O tax.** With respect to the manufacturing B&O tax, the tax is due when the manufacturing process is complete and the property is available for



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lease. To the extent the manufacturing B&O tax exceeds the amount of the multiple activities tax credit available in the initial reporting period, a credit for the lesser of the wholesaling or retailing B&O tax may be claimed on subsequent returns for the manufacturing tax previously paid on the full value of the article manufactured. The credit claimed under the B&O tax classification that applies to the lease income on subsequent returns and the amount claimed under the multiple activities tax credit may not exceed the value reported for the manufacturing B&O tax.

(iii) **Example.** A company manufactures medical equipment in Washington that it sells and leases to hospitals around the country. The value of the manufactured medical equipment is \$10,000. The monthly rental amount is \$1,000 per machine. During March, the Company manufactures five machines that are all leased to Washington hospitals. Under the manufacturing classification, the company will report a taxable amount of \$50,000, with a tax due amount of \$242 ( $\$50,000 \times .00484$ ). Under the retailing classification, the company will report a taxable amount of \$5,000 ( $5 \times \$1,000$ ), with a B&O tax due amount of \$23.55 ( $\$5,000 \times .00471$ ). On the March tax return, the company is entitled to a multiple activities tax credit of \$23.55, the lesser of the manufacturing and retailing B&O taxes computed to be due on the leasing activity. On subsequent returns, the company may continue to claim a multiple activities tax credit under the B&O tax classification until the amount reported for the leasing activity equals the value reported for the manufacturing B&O tax.

(4) **Bailment.** A bailment is the granting of the temporary right of possession and use of tangible personal property to another person, the grantee or bailee, without consideration.

(a) **Tax-reporting responsibilities associated with bailment.** Unless exempt by law, use tax applies to the value of property held or used under bailment if the bailor purchased or acquired the property without payment of Washington's retail sale tax or use tax. The tax liability is that of the bailor or of the bailee if the bailor has not paid the tax. No further use tax applies to bailed property after the bailee or any previous bailee has paid use tax on the value of the property at the first time of use. Government contractors using or installing tangible personal property provided by bailment, should refer to WAC 458-20-17001 (Government contracting Construction, installations, or improvements to government real property).

(i) **Measure of tax – Bailor.** The measure of use tax to the bailor is the true value of property at the time the property was first put to use by the bailor in Washington. RCW 82.12.010.

(ii) **Measure of tax – Bailee.** The measure of use tax to the bailee is the reasonable rental value of the property. This value is to be determined as nearly as possible according to the rental price at the place of use of similar products of like quality and character. Absent rental prices for similar products, the bailee may compute use tax by prorating the true value of the property at time of first use by the bailee over the period of the bailee's possession.

If the nature of the article is such that it is only used once during the bailment period, the reasonable rental is the full value of the article used.

(b) **Limited exemption--Tangible personal property consumed in research, development, experimental, and testing activities.** A bailee's use of any tangible personal property which is entirely consumed while conducting research, development, experimental, and

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testing activities is not subject to use tax providing the bailor's use or acquisition of the property is exempt from retail sales and use tax. RCW 82.12.0265.

**(5) Demurrage charges.** Demurrage charges, also referred to as detention charges, generally are considered to have a double purpose. One purpose is to secure compensation for the use of property beyond an expected period of use and the other is to serve as a penalty or deterrent against the undue detention of the owner's property. Demurrage is often associated with containers of the tangible personal property that is being sold or transported. Examples of property associated with demurrage charges include air cylinders and shipping containers.

Demurrage charges are generally considered income incidental to the activity conducted by the person making the charges. Demurrage charges are not income realized from a lease or rental of tangible personal property.

**(a) Demurrage charges by transportation companies.** The specific public utility tax classification that applies to the associated transportation activity applies to related demurrage charges. Thus, demurrage charges received by a railroad company are subject to the railroad public utility tax classification. Similarly, demurrage charges received by a motor carrier are subject to either the urban or motor transportation public utility tax.

The public utility tax does not apply to demurrage charges when income from the associated transportation activity is exempt from public utility tax, as is the case with certain transportation activities in interstate or foreign commerce. Refer to WAC 458-20-175 (Persons engaged in the business of operating as a private or common carrier by air, rail or water in interstate or foreign commerce), WAC 458-20-180 (Motor transportation, urban transportation), and WAC 458-20-193D (Transportation, communication, public utility activities, or other services in interstate or foreign commerce) for information regarding these activities.

**(b) Demurrage charges by sellers of tangible personal property.** The service and other activities B&O tax applies to charges for the use of property beyond a predetermined period when the property contains tangible personal property sold by the seller. For example, a seller of compressed gases retains ownership of the cylinders even though the buyer keeps the cylinders while using the gases. The buyer must return the cylinders after using the gas and is not charged for the use of the cylinders if returned within a specified period. The service and other activities B&O tax applies to any demurrage charge when the buyer keeps the cylinders beyond the specified period.

**(c) Purchases of property.** The purchase of tangible personal property used to contain property being transported for hire or to contain tangible personal property being sold by the seller when the seller keeps title to the property is a purchase for use as a consumer. Consequently, the purchase of such property is subject to retail sales tax unless the purchase is specifically exempt by law. When the seller fails to collect the appropriate retail sales tax, the buyer is responsible for remitting retail sales tax (commonly referred to as "deferred sales tax") or use tax directly to the department. Refer to WAC 458-20-178 (Use tax) for information about the use tax

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## **NEW SECTION**

**WAC 458-20-266 Providing tangible personal property along with an operator.** (1) **Introduction.** In 2003, the Legislature adopted the definition of "renting or leasing of tangible personal property" as set forth in the national Streamlined Sales and Use Tax Agreement, effective July 1, 2004. The legislation also amends the definition of a retail sale (RCW 82.04.050) to replace the phrase "rental of equipment with operator" with the phrase "providing tangible personal property along with an operator." Chapter 168, Laws of 2003.

This rule provides guidance for determining when a person is providing tangible personal property along with an operator and explains the business and occupation (B&O), retail sales, and use tax reporting responsibilities of these persons. This rule also explains the tax consequences of converting rental inventory to inventory used in providing tangible personal property along with an operator. Persons renting or leasing tangible personal property should refer to WAC 458-20-211 (Leases or rentals of tangible personal property, bailment, and demurrage charges) for information regarding their tax-reporting responsibilities.

(2) **When does providing tangible personal property along with an operator occur?** The providing of tangible personal property along with an operator occurs when the person providing the property also provides an operator that is necessary for the equipment to perform as designed. In those circumstances where the operator's presence is to maintain, inspect, or set up tangible personal property and possession and control of the property is otherwise transferred to the person acquiring the tangible personal property, the transaction is considered a lease or rental of the property. For further information, refer to WAC 458-20-211 (Leases or rentals of tangible personal property, bailment, and demurrage charges).

(a) **Examples.** The examples in this subsection identify a number of facts and then state a conclusion. These examples should only be used as a general guide. Similar determinations for other situations can be made only after a review of all facts and circumstances.

(i) CBA Sound Productions provides and operates lighting and sound equipment (for example, amplifiers, speakers, and controls) for promoters at various live events around Washington. CBA delivers and sets up the equipment, operates the equipment during the performance, and afterward disassembles the equipment. Even though the promoters and/or performers exercise some constructive control over such matters as when and where the equipment is used, the operator is necessary to control the operation of the lighting and sound equipment. CBA is providing tangible personal property along with an operator.

(ii) ABC Crane supplies cranes and operators to Prime Contractor to lift air conditioning units from the ground and to hold the units in place on the roof of a building. Prime Contractor's employees or subcontractors install the units. ABC has no responsibility to bolt the units down, attach wiring, plumbing, or otherwise make the unit operational. Even though Prime Contractor directs ABC as to where the units are to be placed, ABC's operators are necessary to control the operations of the cranes. ABC is providing tangible personal property along with an operator.

(iii) XYZ Concrete Pumping supplies a concrete pumping truck and an operator to Subcontractor. XYZ's operator sets up the pumping equipment and operates the pumping

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mechanism allowing concrete from a premix concrete delivery truck to flow through the pump to the end of a hose. Subcontractor holds and guides the spraying end of the hose, directing proper placement of the concrete. XYZ has no responsibility to build forms, finish the concrete, or otherwise ensure the concrete meets or is placed according to contract specifications. These are Subcontractor's responsibilities. Even though Subcontractor directs XYZ as to when to pump the concrete, XYZ is providing tangible personal property along with an operator

(iv) RT Rentals provides scaffolding to Subcontractor. RT is responsible for providing a technician to setup, move, and dismantle the scaffolding at the construction site. Subcontractor directs RT Rentals as to placement of the scaffolding. Subcontractor assumes possession and control over the scaffolding. RT is not providing tangible personal property along with an operator. Instead, RT is renting tangible personal property to a consumer.

(v) Excavator enters into contract with Prime Contractor to clear and grade undeveloped land in preparation for building construction. Excavator uses bulldozers and other earthmoving equipment to prepare the site in accordance with the design plans. Excavator is not providing tangible personal property along with an operator. Instead, Excavator is performing subcontracting services.

(b) **Further guidance.** Requests for a written opinion from the department regarding whether a specific transaction consists of providing tangible personal property along with an operator or leasing or renting tangible personal property may be submitted in writing, with all pertinent facts, to:

Department of Revenue  
Taxpayer Services Division  
P.O. Box 47478  
Olympia, WA 98504-7478

(3) **Tax-reporting responsibilities associated with providing tangible personal property along with an operator.** The gross proceeds of sales from providing tangible personal property along with an operator are generally subject to the retailing B&O tax. The seller must also collect retail sales tax on the selling price, unless otherwise exempt.

(a) **When is providing tangible personal property along with an operator not a retail sale?** Providing tangible personal property along with an operator is not a retail sale when the activity is by law specifically subject to another tax classification.

When a specific tax classification applies to providing tangible personal property along with an operator, the income is subject to the B&O or public utility taxes, and possibly the retail sales tax according to the classification of the activity. Tax classifications that are often associated with providing tangible personal property along with an operator include but are not necessarily limited to the motor transportation and urban transportation classifications of the public utility tax and the stevedoring classification of the B&O tax. For further discussion about the application of B&O tax and public utility tax to transportation and stevedoring activities, refer to WAC 458-20-180 (Motor transportation, urban transportation) and 458-20-193D (Transportation, communication, public utility activities, or other services in interstate or foreign commerce).



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The following examples identify a number of facts and then state a conclusion. These examples should only be used as a general guide. Similar determinations for other situations can be made only after a review of all facts and circumstances.

(i) Triple J Trucking provides a tractor and trailer along with an operator to Freight Company. Triple J transports goods from Freight Company's facility to various locations within the state as directed by Freight Company over the highways of the state. Triple J is providing tangible personal property along with an operator. Triple J is not making a retail sale, however, because the transportation of persons and property for hire is subject to the motor transportation or urban transportation public utility tax classifications under RCW 82.16.010 and 82.16.020.

(ii) Loader provides Shipper with a crane and an operator to load goods from the dock onto a vessel. These goods are consigned to foreign waterborne carriage. Loader is providing tangible personal property along with an operator. Loader is not making a retail sale, however, because Loader is subject to the stevedoring B&O tax under RCW 82.04.260.

**(b) Purchases of and repairs to equipment used in providing tangible personal property along with an operator.** Sales of property, component parts, and labor and services performed on such property to persons providing tangible personal property along with an operator are retail sales. When the seller fails to collect the appropriate retail sales tax, a person who acquires such property must pay retail sales tax (commonly referred to as deferred sales tax) or use tax directly to the department. Refer to WAC 458-20-178 (Use tax) for additional information about the use tax.

**(c) Converting rental inventory for use in providing tangible personal property along with an operator.** A person who leases tangible personal property to others on a bare rental (true lease) basis and subsequently converts the property to use in providing tangible personal property along with an operator incurs a use tax liability unless retail sales or use tax was previously remitted on the purchase or use of the equipment. The measure of tax is the value of the property at the time the property is first used in providing tangible personal property along with an operator. Refer to WAC 458-20-178 (Use tax) for a discussion about determining the value of the article used.

For example, ZYX Company purchases a crane to rent to others on a bare rental basis without intervening use. The purchase of the crane is not subject to sales tax and provided a ZYX gives a resale certificate to the seller. ZYX Company rents the crane to various lessees on a bare rental basis for two years. During the third year, ZYX Company begins providing an employee to operate the crane. ZYX Company incurs a use tax liability on the value of the crane when it begins using the crane as a consumer to provide tangible personal property along with an operator.